STAGES

Enjoying today. Planning for tomorrow.

Fidelity Investments® | Spring 2004

FOR INVESTORS IN PEAK SAVING YEARS

RISK vs. REWARD

3 ways to measure mutual fund volatility 18

TENDING TO YOUR GOALS

Setting them, reaching them 14

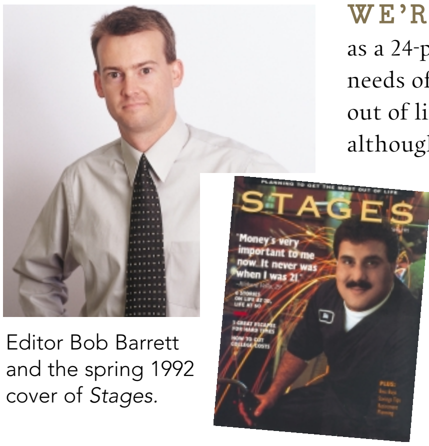
SAVE EARLY, SAVE OFTEN

Peter Lynch's tips for young investors 22

DUAL FOCUS

How Holly Calhoun saves for both retirement and college 8

STAGES | EDITOR'S NOTE



Editor Bob Barrett and the spring 1992 cover of *Stages.*

WE'RE STILL LISTENING In 1992, *Stages* debuted as a 24-page magazine that promised to address the financial needs of 401(k) investors who were "Planning to get the most out of life." Twelve years later, that remains an apt description, although the magazine has greatly evolved from both a visual and content standpoint. Thumbing through my only copy of the premier issue, I noticed that it included an insert card to solicit feedback from readers. What's the biggest financial decision or problem you face in the next five years? What do you like or dislike about this issue? What kinds of stories would you like *Stages* to provide?

Sound familiar? As you may recall, my note in the autumn 2003 issue posed similar questions and encouraged you to reply via an online survey. More than 1,100 readers responded, providing valuable insight into your expectations for *Stages*, your readership habits, and the magazine's relevance to your lifestage and financial goals. Nine in 10 readers either strongly agreed or agreed that *Stages* is informative and useful. Within one week of receiving the autumn 2003 issue, 94% of respondents had read or looked through it. Our new look and design was a big hit with 87% of readers. And your suggestions for future articles covered the full range of personal finance topics, some of which are included in this issue.

A sample of other responses is presented on the next page, in place of our customary letters from readers. While the online survey is no longer available, your comments and opinions are always welcome at stages@fmr.com. Thanks for your feedback, and I hope you enjoy this issue.

Bob Barrett

FIDELITY | RESOURCES

CALL US For automated telephone service virtually 24 hours a day, 7 days a week, call **your plan's toll-free number.** You may also speak to a service representative about your account. Retirement Specialists are also available to help you understand your distribution options.

WIRELESS Fidelity Anywhere℠ now gives you the freedom to access Fidelity NetBenefits® and conduct certain transactions virtually anytime, anyplace.

- Via PDA — Palm™ V with OmniSky service, Palm™ VII/VIIx. Visit http://my.palm.com and click on the Fidelity Investments logo within the Wireless-Ready Web box on the right of your screen, and then click on the download button for the Fidelity Anywhere℠ application.
- Via Internet-ready phone (Verizon, Sprint, Nextel).

LOG ON Visit NetBenefits℠ at the following Internet address for account information, investment information, planning tools, and *Stages Online:*

- **www.401k.com** for employees of corporations and private companies.

Publisher
Candace Race

Editor
Robert Barrett

Online Editor
Connie Blaszczyk

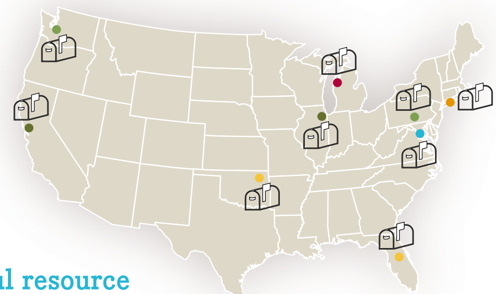
Design and Art Direction
SmartMoney
Custom Solutions

Compliance Reviewers
Thomas Hohl
Christopher Rings

This page: Photograph by Kim Lowe. Illustrations by Leo Espinosa. Cover: Photograph by Mark DeLong

feedback

***Stages* readers share their thoughts and opinions**



More than passing interest

I thoroughly enjoy *Stages* and always look forward to receiving it in my mailbox. I even keep back issues for future reference. In my opinion, there is no better personal finance publication that packs so much relevant and useful information into a nice, concise 24-page magazine. Thank you for the valuable knowledge you provide.

Brian Penn, Naperville, Ill.

I am a strong believer in investing in my 401(k) plan and I am an avid reader of *Stages*. If I can't start reading it the night it comes, it is the first thing I read at the next opportunity. It is one of the most informative magazines I have put my hands on when it comes to investing for retirement, and I look forward to receiving each and every issue.

Barbara Hollenkamp, San Carlos, Calif.

I enjoyed reading the autumn 2003 issue of *Stages*. It was very clear, concise, and to the point. The issue also had a variety of educational and interesting articles. I look forward to the next issue.

Barbara Soeyadi, Lake Grove, N.Y.

Strong support for Real People

Your use of Real People stories helps average people such as me relate to money. *Stages* has helped me greatly over the years.

Scott E. Stevens, Tulsa, Okla.

Stages helps me plan for my future and it also motivates me. The articles about Real People prove that you do not have to make or have lots of money to get on the right track to save and invest.

Kimberly DeCambre, Orlando, Fla.

I enjoy sitting in my easy chair, with a cup of coffee at hand, while digesting each page of *Stages*. I especially like the Real People profiles because they allow me to compare my present financial condition with others who have similar goals.

Robert M. Hughes

A helpful resource

I referred to several pages from your autumn 2003 issue as I was reviewing my investments. One article helped me check on my exposure to international investments. Another was a good resource for ensuring my various portfolios are not "doubled up." Good information even for the seasoned investor, which I, most assuredly, am not. Overall, I am eager to receive the next issue.

Charles E. Block, Bel Air, Md.

Targeting twenty-somethings

As a 24-year-old still learning about investing and retirement planning, I enjoy the format of *Stages* and how easy it is to read through. Naturally, I would like to see more articles about people just starting out in the workforce and planning for retirement many years away.

Jonathan Copley, Hanover, Pa.

I'm 27, single, no kids, no pets, and usually find about 25% of your magazine is of interest to me. Selfishly, I'd like to read more about topics relevant to people with no debt, good cash flow, and opportunities for investing and saving.

Brian Wild, Seattle, Wash.

How about…

…some articles for the workers who will gross only $25,000–$30,000 a year. Not much left over after housing, food, insurance, and taxes. What do we do when we retire with less than $100,000 in savings?

Brian Hodge, Empire, Mich.

…an article about people who don't want to retire early, or even on time. Or people who tried retirement, and then chose to go back to work.

Keith Montague

CALLING ALL REAL PEOPLE

Would you like to be featured in *Stages*? If you think you're a good candidate, please drop us a line to tell us your story.

Stages® Magazine
P.O. Box 55017
Boston, MA
02205-5017

Stages@fmr.com

real life

IN SIGHT

PERSONAL FINANCE

REAL PEOPLE

REALITY CHECK

A refresher on three investing fundamentals

The financial markets have delivered a little bit of everything over the last few years. Everyone remembers the difficult lows — particularly in late 2001 and into 2002 — when it seemed that all asset classes were spiraling downward. And then there was the rebound of 2003, when many 401(k) investors regained their optimism. Good or bad, the numbers reflect one of the fundamental realities of investing: Financial markets are always unpredictable and sometimes volatile.

Allocate your assets

One way to protect yourself from market ups and downs is to develop an asset allocation strategy. Asset allocation is the process of spreading your investments among three different asset classes — stocks, bonds, and short-term investments. By taking advantage of this concept, you can invest some assets for growth, some for income, and some for safety.

Diversify your investments

Properly diversifying your assets is another way to manage risk — the idea of not putting all your eggs in one basket. Beyond allocating your assets, spreading your investments among many different securities in a wide range of industries may vastly improve the odds of your portfolio benefiting from a greater number of economic or market developments. While some of your investment choices may falter, others may perform well, although neither asset allocation nor diversification ensures a profit or guarantees against loss.

Rebalance your account

Maintaining your asset allocation can be achieved by rebalancing your portfolio if it has strayed from your target mix. When one asset class is performing well, its proportion of your overall portfolio swells. Rebalancing to your target allotments requires you to sell part of that soaring asset class, to bring it back down to your intended weighting. At the same time, you'll want to increase your stake in a lagging asset class, to boost it back to your target allocation.

TOP VALUE

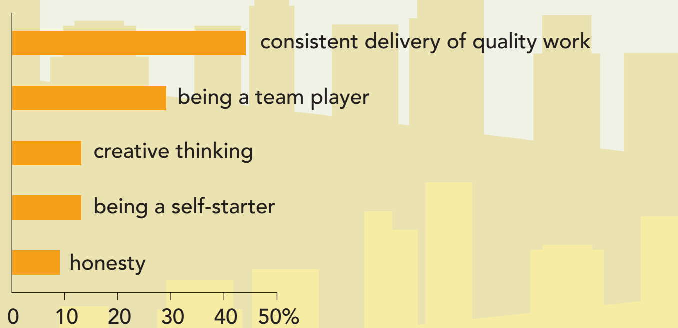
Quality work

POLL EXAMINES BOSS–EMPLOYEE DYNAMICS

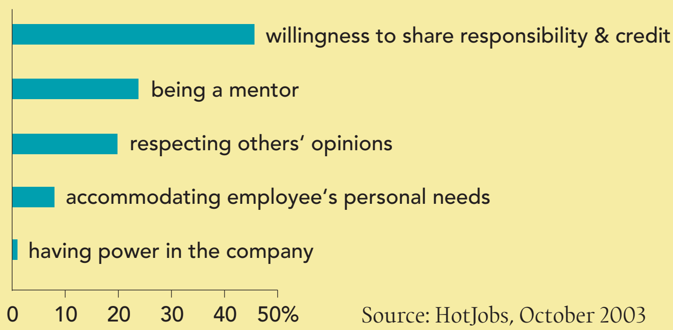
Next time you want to impress your boss, try exhibiting your dedication to quality work or your willingness to be a team player. What may not be as impressive is your ability to think "outside the box," according to an October 2003 survey conducted by HotJobs to determine the qualities managers most value in their employees.

What do employees look for in a boss? The most important quality, according to 46% of the workers surveyed, is a willingness to share responsibility and credit.

What do managers most value in their employees?



What do employees look for in a boss?



Source: HotJobs, October 2003

Illustration by Todd Gilmour

Asset management

Taking stock of your personal possessions

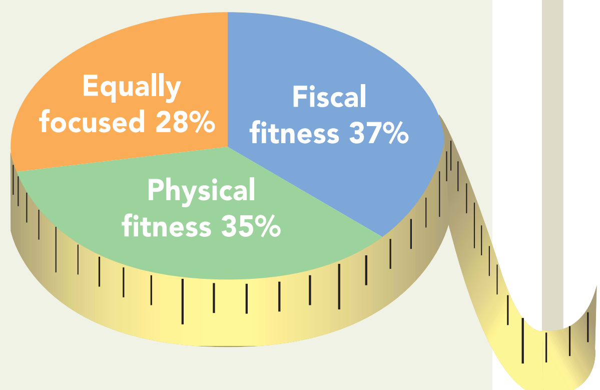
When was the last time, if ever, you compiled a list of your belongings? "Everyone should have an up-to-date inventory of his or her personal assets," says Steve Anderson, a consultant and speaker with the Independent Insurance Agents and Brokers of America. While homeowners' policies generally cover personal property at 40%–50% of its value, many limit coverage for jewelry, silver, and antiques. That's why creating a personal asset inventory is the first step to making sure your special "stuff" is covered in the event of fire, theft, or other loss.

Start by making a list of *all* your valuable and meaningful items, from granny's dishes to Disney lithographs. Anderson suggests making note of the date (or at least the year) you got the item, where you got it, how much you paid, and its current value. Software may make the job easier, but a spreadsheet or hand-written list will work just as well, as will a narrated videotape. "Walk around your house with a video camera, talking about certain items — when you got them and how much you paid," suggests Anderson. Be sure to mention heirlooms, like silver service and hand-stitched quilts, and their appraised value.

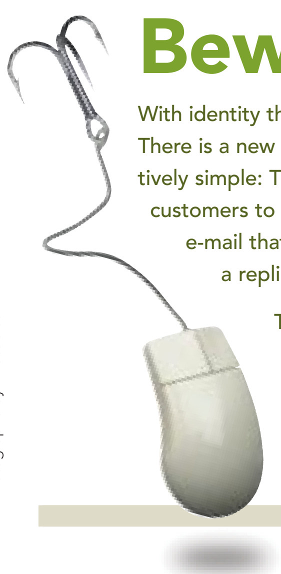
As a next step, stash your own copy in a lock box or fireproof safe and send a copy to your insurance agent. Discuss your need for extra coverage for special collections such as stamps or rare books. When you update your inventory (annually, at least, according to Anderson), be sure to send a copy to your insurance agent.

Lose weight, gain money, or both?

*Question:
In 2004, are you more focused on improving your physical fitness or your fiscal fitness?*



Source: RoperASW poll commissioned by Bankrate, Inc., December 2003.

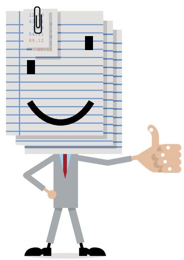


Beware the "phishing" scam

With identity theft on the rise, Fidelity wants customers to have all the information currently available to avoid becoming victims. There is a new form of identity theft, called "Web phishing," targeting financial institutions and their customers. The scam is relatively simple: The Web "phisher" replicates a legitimate company's electronic communications with the intention of getting customers to submit their Social Security numbers, account numbers, and passwords. For example, a customer might receive an e-mail that appears to have been sent from Fidelity requesting personal information. Alternatively, the phisher could create a replica of Fidelity's Web site and then send an e-mail asking a customer to click through and log in to the fake site.

To help distinguish legitimate Fidelity e-mails from potential scams, we want our customers to know that whenever Fidelity requests any personal information electronically, we also ask customers to go through our standard authentication process. This process requires customers to enter their user ID and personal identification number, or PIN, prior to entering additional personal information. As further protection for Fidelity customers, when any of the personal data in a Fidelity account is changed, we send a confirmation notice through the mail to confirm the change.

Photographs by Photodisc



POINT of ORDER

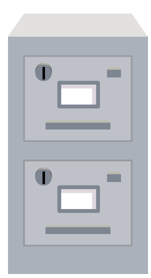
Follow these guidelines to get control of the clutter

By Christy Fisher

With April 15 approaching, now is an opportune time to get your financial house in order. Preparing your taxes will be much easier once you've sorted through that pile of pay stubs, utility bills, bank statements, credit card receipts, and investment statements. But before pitching them or adding to your already overflowing file cabinet, make sure you're familiar with the following general guidelines about what to keep and what to toss.

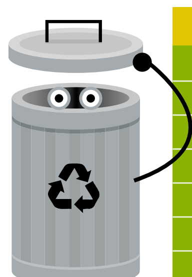
The tax man cometh: If the financial records support the income and deductions claimed on your federal tax return, you'll want to save these records for at least three years from the time you file or the filing deadline date, whichever is later. An Internal Revenue Service (IRS) audit must be done within three years of filing, but the IRS has six years to challenge the return if it thinks you've under-reported your income by at least 25%.

Proof positive: Hold on to records that provide proof of purchase for a product that is under warranty. Keep these records as long as you own the product, or its warranty period expires, says Robert Matheson, a certified financial planner in Naples, Fla. Retain receipts or canceled checks for big purchases. You'll want proof of their value in the event of loss or damage.



Dispose of properly

Shred unimportant or redundant financial records once monthly, quarterly, or year-end statements arrive, says John W. Roth, a federal tax analyst with CCH Inc., a tax and business law publisher in Riverwoods, Ill. But make sure you eliminate sensitive personal information, such as your Social Security number, address, and account numbers.



Pitch ATM receipts and canceled checks (except those that you may need for tax, insurance, or warranty purposes) once the transactions are cleared and you get a monthly banking statement. Destroy unnecessary credit card slips and monthly statements when purchases and payments are correctly accounted for. Throw out all but your last pay stub once you get a W-2 form. Eliminate your mortgage, retirement, and investment statements only if you get a complete summary report at year-end.

Safe keeping

Keep records of the purchase of your home and permanent home improvement receipts indefinitely, Matheson advises, especially if profits from previous home sales haven't been reported on your taxes. Home purchase records are wise to hold on to for legal reasons and are necessary for computing capital gains on the sale of your home for tax purposes.

Also, retain investment records that establish the cost basis, or the amount you originally paid for an investment, for at least three years after a sale.

FILE

DOCUMENT	KEEP...
Income-tax return	indefinitely
Form W-2 and supporting tax-related documents	at least 3 yrs
Investment account statements	at least 3 yrs, post sale
Home purchase records / home improvement receipts	indefinitely
Retirement savings records	indefinitely
Active life insurance and long-term-care policy	indefinitely

TRASH

DOCUMENT	THROW OUT AFTER...*
ATM and credit card receipts	a month
Canceled checks	a month
Household utility bills	a month
Credit card statements	a month
Pay stubs	year-end
Monthly bank statements	year-end
Monthly, quarterly investment statements	year-end
Monthly, quarterly retirement investment statements	year-end

*Save canceled checks, receipts, bills, and credit card receipts that are needed for tax, insurance, and warranty purposes. But pitch the items of no value once you get your monthly confirmation statement. Also, get rid of unneeded monthly and quarterly statements only if you get a complete year-end summary statement.

Illustrations by Fred Rix

How do you measure up?

Financial ratios help you assess your fiscal fitness

By David Whitemyer

"I've got all the money I'll ever need," comedian Henny Youngman once joked, "if I die by four o'clock." That's certainly no way to plan life's investments. But how long could you last on your savings?

Financial ratios can help answer that question. Used by mortgage lenders and business analysts to gauge risk and measure fiscal vitality, financial ratios are a simple tool for measuring how much money you have, and how much you owe.

"In an ideal world, personal financial ratios would function similarly to health ratios, like blood pressure and body mass," suggests Dr. Ruth Lytton, associate professor of financial resource management at Virginia Tech University. "There'd be widespread public awareness and motivation for annual checkups."

Cash–asset, debt–limit, annual-debt–service. The list of ratios goes on and on. And you don't need to be a CPA to do your own annual checkup. Using elementary math skills, anyone can tally up the most helpful ratios: liquidity and debt-to-asset.

Staying afloat on liquid dough

Your liquidity ratio determines the capacity of your household to meet current obligations, should your income draw to a blinding halt. To determine your liquidity ratio, divide your total liquid assets by your monthly expenses. Let's say you have $1,000 in a checking account and $9,000 in a money market fund. That's 10 grand in liquid assets. Your monthly expenditures, including house payments, equal $2,000, so your liquidity ratio is 5:1. You're in good shape, since most financial advisers recommend achieving a ratio of at least 3:1, or 6:1 if you're self-employed.

In the black or in the red

Debt-to-asset ratio determines solvency. To be insolvent is to have a negative net worth, where debts exceed assets. In short, it's the first step toward bankruptcy.

Ignoring housing costs and equity, divide your total liabilities by your total assets. Financed automobiles and credit card debt are common liabilities. If you owe $25,000 in student loans, for example, and another $5,000 on a car, your debt equals $30,000. Adding up your stocks, 401(k) balance, and passbook account, say your assets total $60,000, making the debt–to–asset ratio a healthy 0.5:1. You're solvent! If the debt side of your ratio is above 1.0, you're insolvent.

"Although insolvency is cause for alarm," advises Lytton, "the degree of alarm must be considered relative to the stage of one's financial life cycle." An insolvent 50-year-old considering retirement would be in more of a predicament than would a recent college graduate with strong future income potential.

Laugh all the way to the bank — or not

In fact, when you do a financial checkup with ratios, the final numbers don't express the complete picture. You must gauge the results with your own goals, your personal aversion to debt, and your need for security.

Charles Dickens expressed a sort of financial ratio in his classic *David Copperfield*, when Mr. Micawber explained, "Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought six, result misery."

Happiness should be the desired result, but as most will agree, money doesn't buy happiness. What Dickens' character was hinting at was that a healthy financial ratio may lead to peace of mind.

Learn about more financial ratios in the NetBenefits Planning Center, at **http://planning.netbenefits.com**.

Illustration by John Ritter

Winning game plan

By Jennifer Gottlieb

FRANK CHENEY

AGE
29

EMPLOYER
PROQUEST COMPANY

OCCUPATION
SOFTWARE ENGINEER

HOME
HOWELL, MICHIGAN

Retirement planning challenge: As graduates of rival universities in Michigan, Frank Cheney and his wife, Angela, cheer for opposing sides on game day. But they're on the same team when it comes to managing money. "We're committed to having not only the same standard of living when we retire, but something even better," says Frank, 29. To meet their ambitious goal, the Cheneys know they have to live well within their means and make some tough decisions about how to save and spend.

Frank and Angela grew up in Hartland, Mich., met in high school, and last April moved to nearby Howell to build a house and raise their daughter, India, now three years old, adopted in August 2002. "She's our world," says Angela, 30, who left her job as an editor to be a stay-at-home mom. Now a single-income family, the Cheneys have to be extra economical as they adjust to a new mortgage, save for India's college education, and continue to put away money for retirement.

His solution: The Cheneys seek savings at every turn, refuse to carry credit card debt, and follow a carefully planned budget. By capitalizing on low interest rates and making a sizeable downpayment, the couple built a house twice the size of their old one for only $300 more a month. Their own student loans were paid off ahead of schedule, and they are contributing to a 529 college savings plan.

Every month the Cheneys direct $400 to a savings account. "We maintain our savings account for unexpected expenses, not shopping sprees," Frank says. Until recently, Frank commuted to Ann Arbor in his 1996 Monte Carlo, enduring a rash of repairs to keep it on the road for as long as possible. He finally replaced it in November when he bought a 2004 model. "We knew it was coming, and we were financially prepared," says Frank, who got a bargain price by taking advantage of a manufacturer's rebate and a discount program offered through his employer, and by redeeming $1,500 worth of bonus earnings through a credit card.

"We don't buy things the minute we want them. Instead, we prioritize, budget, and save."

His investment strategy: Frank explains, "It's all based on immediate need versus growth potential." So the Cheneys allocate assets among accessible checking and savings accounts with low interest rates, more moderate money market accounts and CDs, and aggressive retirement and college savings plans.

All in all, Frank and Angela feel good about getting an early start on their long-term retirement plan. "We've heard from a lot of older people, 'Man, I wish I'd started saving for my future when I was your age,' which gives us the motivation to keep doing what we're doing," Frank says.

Support from his plan: Frank is making maximum contributions to his 401(k) plan, and appreciates that ProQuest Company kicks in another 3%. While the Cheneys review their account daily, they only make changes annually, on average. "We watch the numbers go up and down, and that's okay," says Frank, "because we're in it for the long haul."

Photograph by Jun Pino

PILOT PLAN

Photograph by Tim Tadder

By Miranda Hitti

Retirement planning challenge: Navigating a 737 between Los Angeles and Anchorage is a matter of routine for Jacqui Marty, a pilot for Alaska Airlines. "I absolutely love my job," says Marty. But when it comes to plotting her course to retirement, the 36-year-old isn't nearly as comfortable or confident as she is in the cockpit. "I am a bit overwhelmed tracking my various investments, and I am really feeling the need to simplify," she says.

Finding the means to save is not an issue for Marty, who is single. "I'm definitely a saver and always have been," she says. But finding time to review and maintain her extensive mix of investments is another story. Lacking a logical overall plan, Marty is left with the nagging feeling that the financial decisions she's making now may not be consistent with some objectives down the road, such as providing financial support to her parents as they age.

Her solution: Marty makes maximum contributions to her Alaska Airlines 401(k) plan and the retirement-savings plan she's eligible for as a reservist in the U.S. Air Force. She invests monthly in three mutual funds, although these assets are not part of her retirement nest egg. And she's a strong believer in the investment value of real estate. Over the years she has purchased five homes, including her recent buy of an investment condo for which she already has a tenant.

Marty is satisfied with her investment decisions overall, but sometimes wonders whether she may be forfeiting some short-term — but well-earned — pleasures while dutifully funding her long-term goals. In response, she is considering cutting back on her non-retirement mutual fund investments, which could also free up a little pocket money for vacations, competing in mini-triathlons, or surfing lessons.

Her investment strategy: Calling herself a "fairly aggressive" investor, Marty draws upon her professional experience when choosing investments. For instance, she recognized a potential winner in an airline mutual fund that she thought was undervalued in recent years. "I knew it would bounce back, and it's doing very well for me," she says.

Marty's money-management style differs from that of her parents, who focused less on long-term savings. For years, Marty has put every pay raise and bonus toward retirement. "I'm basing my spending money on a salary I made six or eight years ago," she says.

Support from her plan: Alaska Airlines puts 3% of Marty's salary toward her retirement. She doesn't worry about her investments' day-to-day fluctuations, since she's still decades away from calling it quits at age 60, the federally mandated retirement age for pilots.

Though she's working through some turbulence in terms of planning, Marty is confident that her savings-oriented instincts should help her navigate to the comfortable, travel-oriented retirement she seeks.

JACQUI MARTY

AGE
36

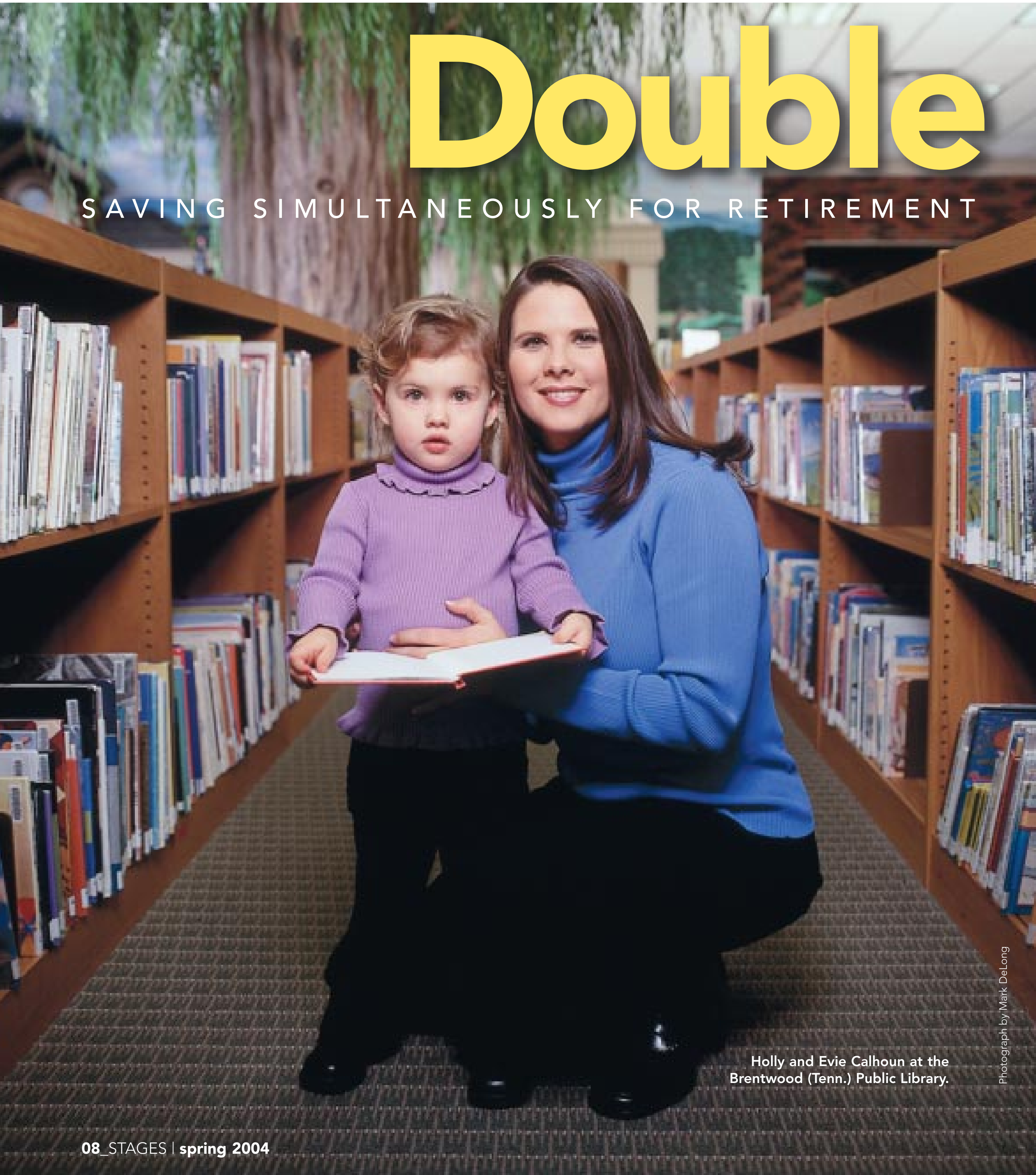
EMPLOYER
ALASKA AIRLINES

OCCUPATION
PILOT

HOME
SAN DIEGO, CALIFORNIA

Double

SAVING SIMULTANEOUSLY FOR RETIREMENT



Holly and Evie Calhoun at the Brentwood (Tenn.) Public Library.

Photograph by Mark DeLong

duty
AND COLLEGE

By Lisa Predella

Holly Calhoun is not easily intimidated by long-term financial goals, even those carrying a hefty price tag. At age 32, Calhoun is a long way from retirement, but she's already eight years into a disciplined savings plan she has followed since starting her professional career in the automotive industry.

"From day one, I made it a priority to invest the maximum in my 401(k) plan," says Calhoun, who was heeding the practical yet powerful advice — save early, save often — of her mentor at Toyota Motor Manufacturing. Today, as an engineer for General Motors, Calhoun continues to make the most of her workplace retirement savings plan by directing maximum contributions into a diversified portfolio of mutual funds.

It's no surprise, then, that Calhoun and her husband, John, have been similarly responsive in preparing and planning for another long-term financial goal: a college education for their two-year-old daughter. "After Evie was born, we couldn't wait for her Social Security card to arrive in the mail so we could open a 529 account and begin saving right away," says Calhoun, of Brentwood, Tenn. "We knew that if we didn't start early, we'd pay for it later by sacrificing our lifestyle or having to work longer. Now, we're in good shape to meet both goals."

The Calhouns are hardly alone in facing financial "double duty" — simultaneously saving for retirement and college. And though it can feel like climbing two mountains at once, there's a lot you can do to scale both peaks. Experts say getting an early start is an important first step, followed by maintaining your discipline and long-term focus. It's also helpful to make the most of tax-advantaged savings vehicles available for both retirement and education.

But that's not to say meeting the challenge will be easy or without sacrifices. Even with sacrifices, you may find it difficult to pursue both goals. If that's the case, "Make retirement your priority," says Amy Noel, a certified financial planner in Boulder, Colo. She advises her clients to save 10% to 15% of their pay for retirement, before they start saving for college. "You can always borrow money for college, but that's not true for retirement," she says.

Put time on your side

Whether you're saving for retirement or education, an early start should make the task easier. "Time is your best asset because it will allow the earnings on your investments to benefit from compounding," says Kalman Chany, author of *Paying for College Without Going Broke* and founder and president of Campus Consultants, in New York City.

Chany also points out that regular contributions, even small amounts, can add up over longer periods of time. "You don't have to start out putting away $500 a month for college," he says. "It's more important to establish the savings discipline early, even if you start with $100 a month now and gradually increase that over time, or add to it if you get a windfall, such as an inheritance or a bonus at work."

It also helps to have an understanding of your projected need, as Calhoun had before she began saving for Evie's education. "My goal was to put away at least $3,000 a year, and to have $130,000 saved by 2018, based on the estimated cost of public college, with inflation built in," says Calhoun. She and her husband fund Evie's 529 account with portions of their child tax rebate, income tax refunds, and job bonuses. "We never miss the money because it doesn't come out of our paychecks," she says.

With respect to college cost estimates, the College Board's "Trends in College Pricing 2003" reports that the average yearly costs of public and private college for the 2003–2004 school year are $10,636 and $26,854, respectively. At those rates, in 18 years, assuming an average annual increase of 6%, the tab for four years of college will be $132,808 (public) and $335,316 (private), according to a college cost calculator at www.finaid.org.

Those are intimidating numbers, indeed, but Chany cautions against looking at them in isolation. "These projections assume you're paying 100 percent of the bill, when, in fact, you might be eligible for financial aid or plan to defray the costs with loans," he points out.

Help is available

The numbers are also less frightening when you consider the various financial products available today — and the various tax benefits they provide. One of the most popular ways to save for college is a 529 College Savings Plan. Sponsored by individual states and professionally managed by independent investment firms, these plans allow the participant (parents and grandparents, for example) to retain control of the assets, offer federally tax-free withdrawals for qualified higher education expenses, and have high contribution limits (between $100,000 and $270,000), among other benefits.

"If you want to save for both goals, you may have to make important decisions about your spending habits."
John Henry McDonald, CFP
Austin, Texas

There are also prepaid tuition plans, which lock in today's tuition rates and allow assets to be applied toward future tuition at any of your state's eligible colleges and universities. In addition, Coverdell Education Savings Accounts permit savings of up to $2,000 per year, with tax-deferred earnings and federally tax-free distributions for qualified education expenses. Finally, there are custodial accounts called Uniform Gift to Minors Act or Uniform Transfer to Minors Act accounts. Noel cautions against custodial accounts, however, since your child can do whatever he or she wants with the money upon reaching the age of majority.

Before you make your choice, be sure to factor in your likelihood of qualifying for financial assistance. "If you don't think you'll qualify, putting more assets in the child's name might offer certain tax advantages," says Chany. "If you do plan to apply for aid, however, don't put your savings in your child's name, since this can have a punitive effect on your aid eligibility." The good news, according to Chany, is that "saving for retirement won't impact your aid eligibility, because financial aid officers don't include these assets in their formulas."

Many financial planners suggest a combination of college saving strategies. Says Noel, "I recommend putting some money in a 529 plan, some in taxable accounts, and paying for college partly out of cash flow. I like the flexibility of being able to go in any direction when it comes time to pay the tuition bill."

Finding balance — and a few extra bucks

You'll need that same financial flexibility when it comes to maintaining your lifestyle in retirement. That's why meeting the "double duty" challenge is best achieved with a well-balanced *overall* financial plan that does not compromise your retirement savings strategy. Financial planners agree that the benefits of a 401(k) are too good to pass up, and that these plans should be the cornerstone of your nest egg–building effort.

The reality is, your cash flow may limit how much you can save for retirement and college. "If you want to save for both goals, you may have to make important decisions about your spending habits," says John Henry McDonald, a certified financial planner in Austin, Texas. "Going out to dinner and sharing an entrée, buying a used car, or even moving into a smaller home can improve cash flow and increase your opportunity to save."

Calhoun credits her disciplined saving to comparison-shopping and paying cash. "I also have each of my bills automatically debited from my interest-bearing checking account so the money will draw interest up until the day the check is drafted." Also, she says, "with interest rates at record lows, we refinanced our house to a 15-year mortgage."

Bridging the gap

There are many ways to make up a savings shortfall for both retirement and college. For retirement, it may be a matter of working longer, working part-time, or shifting your investment strategy. Fortunately, there are resources, such as financial aid and student loans, to help make up the shortfall in your college savings. Chany says that "just because you own your own home and have savings in the bank, don't assume you're ineligible for aid."

Another strategy is simply to reduce how much you'll have to spend on college — perhaps by asking your child to help pay for his or her education, or choosing a less expensive school. "Though many parents are emotionally invested in paying for college," says Noel, "you don't have to pick the most expensive school to get a good education." McDonald says, "There's nothing wrong with sharing the cost of college with your child. Have this discussion early, though, perhaps a few years before college, so he or she knows what to expect and can start working and saving," he adds.

The double duty of saving for retirement and college is challenging — but not impossible. It's simply a matter of using all available resources, including tax-advantaged savings vehicles and a range of college-financing alternatives. Because there are more short-term strategies available to pay for college, however, be sure to make retirement your savings priority.

The experience of this investor may not be representative of the experience of all investors and is not indicative of future performance or success.

Pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), qualified distributions are federal income tax free. The provisions of EGTRRA will expire on December 31, 2010. Unless the law is extended by Congress and the President, the federal tax treatment of 529 plans will revert to its status prior to January 1, 2002.

DIG DEEPER INTO DOUBLE DUTY

Are you in a college cost CRUNCH?

Few words in the English language evoke as much financial angst for parents as "college tuition." While most parents can never expect to put aside enough money to cover the entire cost of educating their children, many will cover a significant portion through a disciplined, long-term savings effort. But what if your child is nearing college age, you haven't saved adequately, and your first tuition bill is looming?

To help you devise a plan, we posed this question to Kalman Chany, author of *Paying for College Without Going Broke* and a nationally known expert on college funding. Here's his response.

Bottom line: There are still a number of things you can do. But you'll have to act quickly. As a first step, you should get an idea of your Expected Family Contribution, also known as the "EFC." Compare that number to the cost of attendance at the school (tuition, fees, room and board, as well as allowances for books, supplies, transportation, and personal expenses) to get a rough estimate of your "need."

It may still be possible to make adjustments to lower your EFC before you complete the applications. You'll also want to gain an understanding of how the different responses on the financial aid forms affect your eligibility for aid.

Whether or not you demonstrate need, you'll also want to investigate merit scholarships based on academic talent, creative performing arts ability, athletics, or other special student characteristics. The admissions offices at the respective colleges should be able to give you information about the criteria (and filing requirements, if any). At some schools, to be considered for merit-based scholarships, you'll need to submit the required application(s) a number of weeks before the regular admissions deadlines.

If your family contribution is more than you're ready and willing to pay, you should also have your child apply to lower-cost schools. There's nothing that says your child has to go to a school that costs more than you are prepared to pay. There are many lower-cost college options that offer academic excellence.

Even if you're eligible for a large amount of aid, it will still make sense for your child to apply to a "financial aid safety school," which you'd be able to afford with little or no aid. For most students, this will be a public institution in their home state. Alternatively, you could send your child to a less expensive school for the first two years and then have him or her transfer to a more prestigious college, which would grant his or her degree. Not only would this cut down on the total cost of college, but it would also give you two more years to come up with the additional cash needed for a more expensive school.

It would also make sense to apply to schools where the student's grades, standardized test scores, and other admissions criteria would make him or her attractive to the school compared to other applicants. Many schools engage in preferential "packaging" — where the most desired students get larger financial aid awards or a greater percentage of grants, rather than loans.

If scholarships and financial aid are still not enough, you should also investigate educational loans, such as the federal government's PLUS loan program for parents. These have attractive interest rates, compared with a personal loan from a bank.

This content originally appeared in *Fidelity Investor's Weekly*, an online publication available at **www.fidelity.com/goto/iweekly.**

KNOW WHERE YOU HOLD 'EM

By Clint Willis

An effective asset location strategy can increase the tax efficiency of your retirement savings accounts.

Smart investors are always looking for ways to maximize the return on their investments. Last year's tax cut, the Jobs and Growth Tax Relief Reconciliation Act of 2003, has made that a bit easier. The new law has sharply reduced the top tax rates on investment dividends (from 35% to 15%) and capital gains (from 20% to 15%) you earn from stocks held in taxable accounts.

Less to Uncle Sam, more for you. That's a tradeoff decidedly in favor of investors who hold retirement assets outside the shelter of a 401(k) plan, which grows tax deferred but is ultimately subject to ordinary income tax rates (up to 35%) on withdrawals. Still, it's important to make the right moves to take full advantage of the new rules. It's just as important to avoid false steps that could prove costly, such as redirecting your 401(k) contributions to a taxable account in an attempt to capitalize on the new, lower rates.

Such an approach could indeed be costly, according to Susan Strasbaugh, a certified financial planner in Colorado Springs, Colo. "The power of tax-deferred compounding is such that a 401(k) can continue to offer significantly greater long-term growth than a taxable account," she points out. What's more, a 401(k) plan offers other advantages — such as matching contributions and automatic payroll deduction — that are simply too good to refuse. "The tax laws could change 20 times before you retire," Strasbaugh continues. "Meanwhile, tax-deferred accounts, such as a 401(k), are still very compelling."

Top priority: asset allocation

The recent changes may have some implications for the decisions you make about your overall retirement savings strategy, however. In particular, the lower rates applied to taxable accounts raise the important but often overlooked issue of asset location — that is, determining which types of investments are best suited to taxable and tax-deferred accounts. Not to be confused with its close cousin, asset allocation, asset location should be an important consideration if you don't hold every penny of your long-term savings in tax-deferred accounts.

Like every investor, you must first decide upon an asset allocation strategy: an appropriate mix of growth-oriented stocks or funds as well as more stable, income-oriented holdings. You should then develop an asset location strategy by making careful decisions about which types of investments to hold in taxable accounts and which types can take full advantage of the opportunities provided by tax-deferred accounts. "Asset allocation comes first," says Strasbaugh. "But asset location also can make a significant difference over time."

Taxable vs. tax advantaged

Asset location is an important part of investment strategy for a simple reason: Taxable accounts are different from tax-deferred accounts, such as 401(k) accounts. When you invest in a taxable account, you must pay income tax on the money you set aside. In addition, every year you pay taxes on your dividends and capital gains, which means you have less profit to reinvest in the account each year. By contrast, a 401(k) lets you defer taxes on any salary you invest — and then also postpones taxes on profits, so that your money compounds tax deferred. True, you may pay taxes at a higher rate when you withdraw the money. But the potentially powerful effect of long-term compounding should more than make up for a relatively higher tax rate.

The best of both worlds

Clearly, a 401(k) account is a great way to increase the tax efficiency of your investments. Asset location offers a way to become even more tax efficient, by taking full advantage of your 401(k) as well as any other tax-deferred holdings such as a Roth IRA or a Traditional IRA.

Bear in mind that asset location comes after asset allocation. That is, you must first decide how to divide your total long-term investment portfolio among different types of investments. That done, you can consider the right asset location strategy by deciding which investments will take fullest advantage of the tax breaks in your 401(k) or IRA, and which ones should go into a taxable account.

Fortunately, your asset location strategy can be relatively simple. Start with the fact that fixed-income investments — such as the bond funds in your 401(k) account — generate a regular flow of cash that is subject to relatively high ordinary income tax rates of up to 35% in a taxable account. Taking that fact into account, you may decide to hold all of your fixed-income investments in the shelter of a 401(k).

By contrast, most equity investments generate capital gains and dividends that are taxed at much lower rates — typically 15% — in a taxable account. Thus, many investors who keep some money in taxable accounts will want to use those accounts for shares of stocks or equity mutual funds.

Locating your assets

None of this means you should keep all of your 401(k) savings in bond funds. Chances are, those 401(k) assets constitute the bulk of your long-term investment portfolio. Investors who keep too much money in bond funds could sabotage their portfolio's growth potential. "Most investors should have a healthy dose of growth investments in their 401(k)," advises Chris Kuehne, a certified financial planner in Pound Ridge, N.Y.

Moreover, the tax-related drawbacks of keeping stock funds in your 401(k) may not turn out to be as significant as you might expect. The reason: Stocks' tendency to generate higher returns than bonds do over long periods means that stock funds can take fuller advantage of tax-deferred compounding.

It's also worth considering a fund's turnover rate — the percentage of its assets that are replaced every year. A fund that makes frequent trades is likely to generate more taxable gains than a fund that makes less frequent changes in its portfolio. Thus, for example, passively managed index funds, with their low turnover rates, are sometimes more appealing candidates for a taxable account than an aggressive growth fund with a high-turnover rate.

Illustration by Karen Greenberg

LOCATION, LOCATION, LOCATION

The illustration shows six types of assets you might hold in your portfolio. The ones toward the left tend to be the least tax-efficient outside the shelter of a 401(k) plan or other tax-deferred account. The ones toward the right probably would suffer the least in a taxable account versus a 401(k).

The bottom line: Asset location isn't a replacement for asset allocation or tax-deferred accounts. Instead, it offers a way to make the most of those tools — which remain your most important allies in your quest for long-term financial security.

An investment's return and priciple value will fluctuate and can be more or less than the original cost when redeemed.

Ready Set GOALS

four steps to setting goals and six keys to achieving them.

By Jean Chatzky

Think for a minute about what goals are. At the most basic level, they're wants. Not wants like "I want a Coke" or "I want to see that new Richard Gere movie," but bigger than that. They're your aspirations for the future. For my friends Don and Paige, one goal is to spend the summer of 2005 traveling — literally — around the world. My brother Dave and sister-in-law Ali have set their sights on leaving the city behind and buying a house in the suburbs. My husband and I would like to put an addition on our house (he wants a sunporch, I want a modern bathroom). Goals are bigger than wants. They're *über*wants.

Whether you do it on a piece of paper or on a computer screen or in a conversation over dinner, setting goals explicitly helps you do a number of things. It helps you see them clearly. It helps you flesh them out. It helps you realize all the interim steps you'll have to take to accomplish them. It helps you figure out what the cost might be. And it helps you decide whether the tradeoffs involved are worth it, or you'd rather pursue something else.

And — oh yes — it makes you happy. Goal setters are happier with their finances and less likely to worry about their money. Likewise, financially happy people are more knowledgeable about the amount they need to save in order to reach their goals, and are more likely to be on track to do so.

Although you could just set your sights on a distant goal and try, haphazardly, to reach it, it helps if there's a method to your madness. What's the best way to set goals and be sure you achieve them?

THE 4 STEPS OF SETTING GOALS

See what you want. Visualization is step number one. Sit yourself in a chair and imagine yourself — happy — five or ten or twenty-five years down the road. Be specific. Be clear. One big reason people fail to reach their goals is that those goals were amorphous to begin with. You need to understand: Where are you? What are you doing? Who are you with? How did you get there?

Setting a goal of "buying my first house soon" is too wishy-washy. Deciding you'd like to buy a three-bedroom cape on at least a half acre within thirty minutes of your workplace before the next school year begins is much more specific, therefore much better.

Write your goals down. Like any good idea, goals need to be written down so that you can refer to them every now and then. You may decide to change them, or to abandon them. That's your prerogative. But in the beginning, they need to be in writing.

Why? Because if you don't write them down, you're likely to forget them. I'm not kidding. That's how your brain processes information. When you *see* something — researchers call it a visual stimulus — your brain holds on to that image for about a half second. When you *hear* something, you retain it a little longer, say three seconds. After that, you lose it. Unless, that is, you make an effort to keep that information in the forefront of your mind by repeating it to yourself over and over as if it were a phone number, or by creating a memory jogger like the ones we use to remember people's names (Mrs. Green has green eyes). You can play with it to move it from your short-term memory into your long-term memory, where it will be available for you to recall, or you can go with the easier alternative: You can write it down.

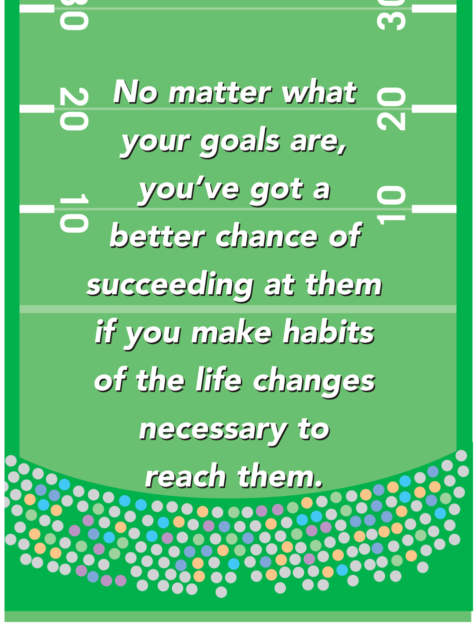
Reprinted by arrangement with Portfolio, a member of Penguin Group (USA) Inc. from *You Don't Have to be Rich* by Jean Chatzky.

Turn your goal into an action plan. Once you've got a goal, you need to figure out what steps you'll need to take to achieve it. That means breaking it down into manageable parts. Say your goal is to save $5,000 in the next year. With all those zeros attached, it sounds daunting. But saving $100 a week for fifty weeks is not so overwhelming. Further, if you know you can come up with that much money by quitting the pricey health club you never attend anyway ($35), eating out one less time a week ($40), and refinancing your car loan ($25), your course is clear.

Understand the time involved. People are funny where time is concerned. We often overestimate how much we can accomplish in a single day, yet we generally underestimate how much we can accomplish in a year if we make just a little progress every day. That's true whether you're teaching a child to swim, turning a plot of unused land into a vegetable garden, writing a book, or — again — trying to lose ten pounds. Quick fixes rarely work. Preparing for a test by cramming the night before is almost never as effective as attending class regularly and calmly reviewing your notes.

THE 6 KEYS TO ACHIEVING GOALS

For setting goals, you get a substantial payoff. For working toward them, you get a greater one. Nearly half — 48% — of Americans who are steadily working toward their goals (or who have achieved them) say they are *very* happy with their lives overall. That's a substantial improvement over the 31% who have just started to achieve their goals, and an even greater leap over the 18% who haven't identified or taken the first step toward theirs. People who have at least started to achieve their goals are much more likely to feel use-



ful, content, and confident. Those who haven't even started are more likely to feel hopeless and stressed. And once you start to make steady progress, worry diminishes as well.

How can you best get there?

Begin. Once you know what your goals are, you have to act on them. Sounds like a no-brainer, I know. But many people are perpetual dreamers who hope and hope, but never implement. What do you have to do? Take the first step — whether it's opening an account at the brokerage firm where you're going to put the $50 you save each week, figuring out how much a three-bedroom house is likely to cost (and how much you'd have to put down), or saying no for the first time in a long time as the dessert trolley passes by.

Recognize the obstacles in your way. Often, as you're moving toward a goal, you can predict the obstacles that will pop up in your way. Jim Ball, founder of The Goals Institute, who helps individuals and corporations structure and meet their goals, tells of working with a group of women in Omaha. One woman, Robin, said she thought she'd feel much better about her financial future and retirement if she were just able to save $50 a month. As a group, they named the goal Robin's Nest Egg and figured out where she could come up with the money (manicures biweekly instead of weekly, double coupons). Then Ball asked her what sort of barriers stood in her way. Robin answered without a second thought: "My husband," she said. "He likes to spend money."

Ball shook his head. "That's not going to work," he explained to her. "He's going to get in your way every step. Unless he has an interest in your saving — unless he sees that there's some reward in it for him at the end of the road — you're not going to be able to save without racking up additional debt. But if you can get him to buy into the program, perhaps together you can save even more."

Likewise, once you've isolated your obstacles, it makes sense to avoid them. Manage your environment so that you have little exposure to the temptations that plague you, whether that means walking out of the path of your favorite shoe store, particularly during the winter sale, or not having dinner with the friend who believes you can't get a good bottle of wine for less than $100, but meeting her for coffee instead. Condition yourself to ignore television ads. The commercial break is the perfect time to check your e-mail, make school lunches, or return a call. Then surround yourself with healthy examples — good money managers, sound eaters, avid exercisers, or other people who embody the characteristics you desire.

Build better habits. No matter what your goals are, you've got a better chance of succeeding at them if you make habits of the life changes necessary to reach them. Most people make the mistake of looking at goals as a point in time some distance away. You're better off if, instead, you can look at goals as a series of lifelong changes you have to make to achieve those desires.

How do you initiate a habit? First, by breaking the old ones. Whether you're trying to quit smoking or stop spending frivolously, start by keeping a record of every time you have a cigarette or every time you open your wallet. What triggers you to light up? What triggers you to spend? When you look over your list, don't be surprised if a light bulb goes on. Your brain can't see your habits. You have to show it when you're smoking. You have to show it when and what you're buying.

When Jim Ball went through SmokeEnders, the record he kept showed that he lit up after a swim. "What are you going to do after a swim when you can't have a cigarette?" his counselor asked. Ball decided he would go for a run. On the counselor's instructions, he visualized it. He repeated it in his mind: Go for a run. Go for a run. Go for a run. It wasn't until summer came around again nine months later that he got a chance to see if it worked. By then, he'd been off cigarettes for nearly six months — but he also hadn't been in the pool. And wouldn't you know it — he jumped into the pool, got out, and had an urge for a cigarette. So what did he do? "I went for a run. I laughed about the fact that I was probably programmed to want the cigarette as much as anything else," he recalls. "But I did it."

You can do the same with fiscal fitness. If you're part of a couple that eats out frequently, you can see the impact of that on your finances. In order for that to happen, you have to quantify it. Maybe each restaurant meal runs $75. And maybe you eat out twice a week. What if you decide that instead of spending $150 a week, you'll spend $75 and invest the rest. After a year, you'll have saved $3,900. That's how you begin to process a goal.

It's important to replace your broken old habits with new and improved ones. The first time you skip that second dinner out, you may find it tough to tell your friends that you can't meet them. The second time, it won't be as difficult. By the third week, they may stop asking — unless you offer an alternative. Weekly potlucks with different international themes? A classic video or DVD night? Don't be surprised if soon those same pals are angling for an invitation.

Automate where you can. You don't have to do all the heavy lifting yourself. These days you can count on technology for a substantial boost, particularly when it comes to saving and investing. Most investments into brokerage, savings, and retirement accounts can be scheduled. You decide how much will be invested, which shares will be bought (specific stocks or bonds, mutual funds, or money-market funds), and when the contribution will be made. You sign on the dotted line, and the transactions happen automatically. If paying your bills on time is a problem, you can schedule those payments as well.

Set up reminders. Whenever you're working toward a goal, if you can see it — clearly and often — you'll be less likely to stray. That's why people stick pictures of Britney Spears' abs and Tina Turner's legs on their refrigerator doors. It's why resorts in the Caribbean spend a fortune on slick brochures and Web sites. And it works. Each time you see Britney in her belly shirt it's a none-too-subtle reminder that you'd like to lose ten pounds. So instead of reaching for the last piece of birthday cake, you grab a pear and do thirty crunches.

Focus on tomorrow. John Wayne once said: "Tomorrow's the most important thing in life. When it arrives and puts itself in our hands, we can only hope we learned something from yesterday." In other words, look forward, not back. Dwell on your successes, not your failures. If you fall off the wagon — spending more than you'd planned, eating more than you'd planned, looking for a job with less fervor than you'd planned — don't consider it an excuse to stop trying. Simply start again tomorrow. After all, reaching your ten-year milestone eleven years from now is much better than never reaching it at all.

By Jack Fehr

THE REAL McCOY

Jennifer McCoy was seven years old when she earned her first weekly allowance — three dimes, a quarter, and a brief parental lecture about the importance of saving. Now 44, McCoy recalls that even at such a young age her instinct was to save. "I liked the feeling of money in my pocket," she says, adding that her goal was to stash away 25 cents each week.

Today, McCoy's financial goals are decidedly more complex, and she's dealing with more than pocket change. Her commitment to financial planning, especially saving, is as strong as ever. But that's not to say her outlook has not evolved over the years. "My financial goals have never been hard and fast," says McCoy, a part-time urgent-care physician at Skagit Valley Medical Center, in Washington. "As my life has changed, my financial goals have changed too. And I've always made sure that a portion of my check goes directly into the bank."

McCoy had barely cashed her first paycheck as a doctor, in 1988, when she faced her first major financial challenge: $100,000 in student loans. Her goal was to pay it down aggressively, which she accomplished in about six years. "I have never felt comfortable with the idea of debt," she says.

Recently, McCoy decided to move to a part-time work schedule, which has allowed her to devote more time to charitable endeavors, including Habitat for Humanity, while also keeping fit by mountain biking and skiing. "I needed the change, personally and professionally, but that also meant my financial goals needed to evolve," McCoy says. Her original long-term goals included buying a first home, creating an endowment for a children's environmental education camp, buying a home for her disabled brother, and retiring at age 50. Some, but not all, remain on her list. A $133,000 house on which McCoy put 25% down last year satisfied the first goal. An environmentalist, she still plans to fund the endowment. However, her reduced income led her to shelve the last two goals — at least for now.

Although McCoy's income is only a fraction of what she used to earn, she has maintained the financial discipline she learned from her parents at age seven. By continuing to save and invest, McCoy can meet evolving financial goals if her life changes again. "No matter what happens, my basic need to save remains the same, she says.

measuring volatility

IF MARKET SWINGS make you queasy, then consulting a trio of measures could provide the gut check you need to achieve a combination of desired returns and peace of mind.

By Jeff Schlegel

When it comes to volatility, not every mutual fund investor has a cast-iron stomach. Let's say your 401(k) plan includes two mutual funds with similar styles. Furthermore, each has gained an average annual return of 10% during the past three years. The choice between the two might seem like a toss-up. But for risk-averse investors, one of those mutual funds might be a better fit because it's less volatile.

Beta, r-squared, and standard deviation can help investors size up a mutual fund's volatility characteristics and how well it has performed vis-à-vis those characteristics, which can lead to investment decisions that are consistent with your risk tolerance. These measures are typically calculated over the most recent three-year period.

Beta

Perhaps the most familiar of the three measures is beta, which tracks how much risk a mutual fund has taken relative to its underlying benchmark index, such as the S&P 500® Index. Beta is a double-edged sword because a higher beta is an indication of greater potential returns *or* greater potential losses. A mutual fund with a beta of 1.00 has mirrored the volatility of its benchmark, meaning that it has more or less performed in line with that benchmark. A high-beta fund of 2.00 is twice as volatile as its benchmark — it could theoretically gain twice as much or lose twice as much. Consequently, if the S&P 500 Index gained 10%, a mutual fund with twice the volatility could jump 20%.

A mutual fund with a beta of 0.50 is half as volatile as its benchmark, so a 10% uptick in the benchmark S&P 500 likely would have produced only a 5% gain, whereas a 12% drop in the index likely would have resulted in only a 6% loss.

"Most investors want to own high-beta stocks in a bull market and low-beta stocks in a bear market," says Lee Hull, president of Hull Capital Management, in Dallas. "If you're worried about the market, you may want to crank down your beta" for stocks and mutual funds.

Of course, beta is an objective measure and risk is a subjective concept. However, opinion counts with beta as well. Hull says you must consider the time frame when judging beta. "When something is in favor, it tends to have a higher beta than normal," he says. You also need to compare betas on an apples-to-apples basis across different mutual fund categories. A small-cap growth fund with a beta of 1.10 doesn't have the same risk profile as a large-cap value fund with a similar beta because the underlying index of the former (the Russell 2000® Growth Index) is generally more volatile than that of the latter (S&P 500).

R-squared

A mutual fund's beta is only as good as its r-squared, which is a historical measurement that indicates how closely past fluctuations have correlated with the fluctuations of its benchmark index. "R-squared is useful when measuring the relevance of a passive benchmark to an actively managed fund," says Jeff Tjornehoj, a research analyst at Lipper Inc. The higher the r-squared number, the more reliable the beta. The rule of thumb is to look for an r-squared of 75 or higher.

A mutual fund's r-squared score can range from zero to 1.00 (or 100, depending on the source), with 1.00 indicating the mutual fund has completely tracked its benchmark index. A mutual fund with an r-squared of 0.80 indicates that 80% of its past movements were correlated to movements in its benchmark index. Some core equity index funds have an r-squared of 1.00, meaning they perfectly track the S&P 500 Index.

The S&P 500 Index is the most commonly referenced benchmark for U.S. stock funds, but it's not always the best comparison for a mutual fund's style and holdings. Investors should look at a mutual fund's best-fit index, which

Morningstar, Inc. defines as the one showing the highest correlations with a mutual fund over the past 36 months.

Standard deviation

The third measure, standard deviation, shows the dispersion of a mutual fund's returns over a specified time period. In other words, it quantifies fund volatility by showing how much the mutual fund has bounced around from its average returns during that time. A high standard deviation indicates greater volatility on both the upside and downside.

On a macro level, equity funds generally sport higher standard deviations than bond funds because they experience wider price swings. To illustrate that, Morningstar fund analyst Dan McNeela reports that the specialty technology fund sector had a standard deviation of 39 for the three years ended October 31, 2003. During that same period, the steady and sedate ultra-short bond fund category sported a standard deviation of 1. Falling somewhat between the two was the large-blend fund family, a combination of growth and income investing styles that scored a 17.

Standard deviation doesn't measure performance, but it can be useful when building a mutual fund portfolio. "It can steer people away from chasing after a hot mutual fund or sector because it reminds people that investments can go down just as much as they can go up," says McNeela. In addition, he notes that standard deviation can help investors diversify their portfolios by choosing a mix of mutual funds across the volatility — and thus, performance — spectrum. "It might be worth taking a small position in a higher standard deviation fund. If it's a small part of the overall portfolio, you don't need to be as concerned with the standard deviation of its return."

Don't lose sight of the big picture

Keep in mind that beta, r-squared, and standard deviation are rearview indicators, and that they don't predict future performance. They also lose their relevance if the fund's style changed during the measured time frame.

These measures should be part of the total mosaic of savvy mutual fund investing that includes evaluating fund managers, watching expenses, knowing a fund's performance during different market conditions, and examining a fund's holdings. After all, investing should be about helping you reach certain financial goals without constantly reaching for an antacid.

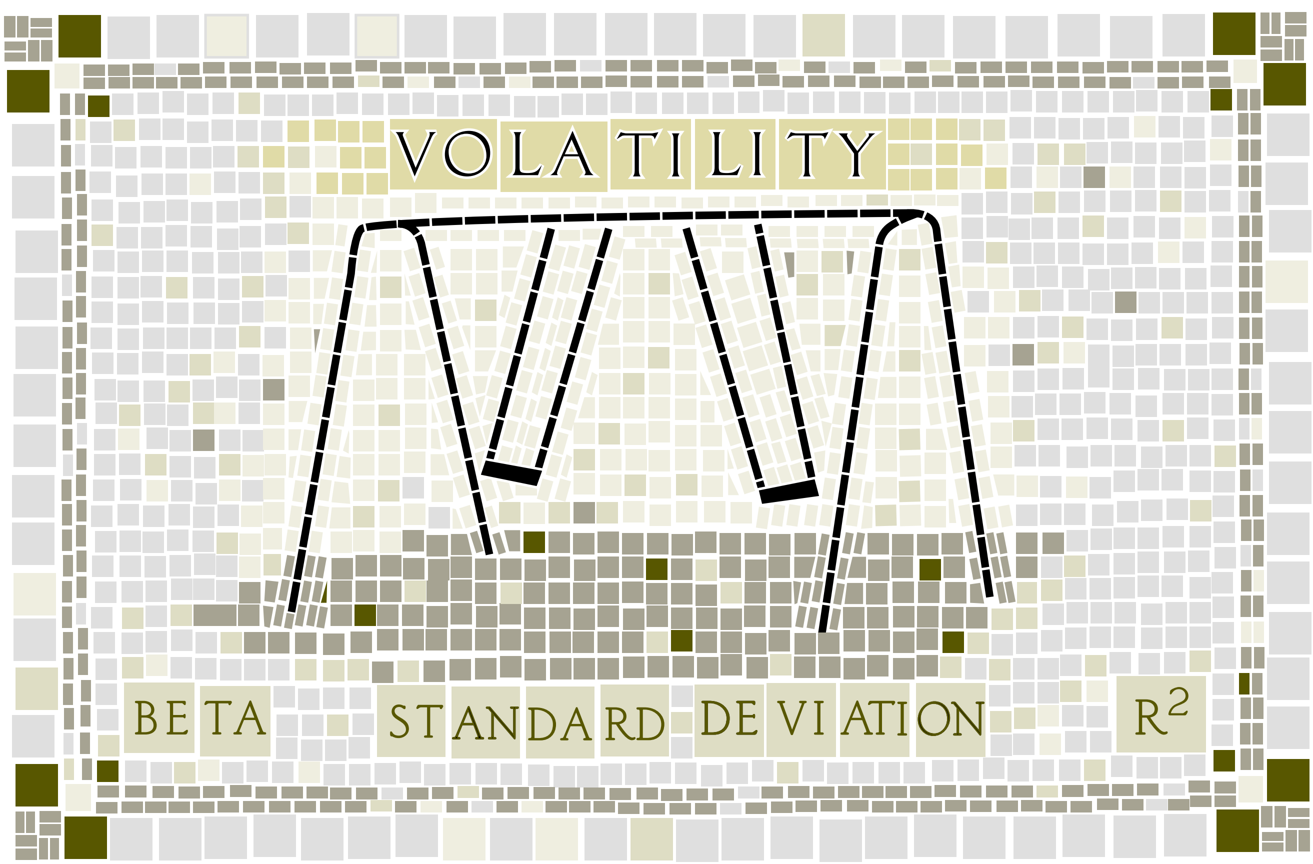


Illustration by Todd Gilmour

7 things you need to know about IRA investing

By Barbara Bedway

By now you're no doubt well acquainted with the various reasons a 401(k) plan can be a potent method for investing toward retirement. Your voluntary contributions not only reduce your taxable income, but any earnings are tax deferred until withdrawn. And, if you're eligible to receive a company match, your 401(k) gets an additional boost. Here's more good news: The limit on your pretax contributions to an employer-sponsored retirement plan has increased to $13,000 in 2004.

Once you've reached that limit, you should consider saving even more by opening an Individual Retirement Account (IRA). As a tax-advantaged investment, an IRA is an effective way to supplement your maximum 401(k) contributions — an important building block toward a more comfortable retirement.

"Investing to the maximum in both a 401(k) *and* an IRA is ideal," says Anthony Luciano, vice president, retirement planning, at Fidelity Investments. "IRAs offer additional opportunities to save even more for retirement, while also complementing the investment choices you've made for your 401(k) account."

Especially as tax time approaches, you may want to consider investing in an IRA. These days you can choose between a Roth IRA and a Traditional IRA. But that's not the only decision you'll face. To help you choose wisely, get acquainted with the fundamentals of IRA investing, highlighted below.

1. Eligibility

Age and adjusted gross income (AGI) are two factors that can impact your eligibility to open an IRA. There are no age limits for a Roth IRA, but there are income restrictions. To make the maximum contribution for the 2003 tax year ($3,000), adjusted gross income (AGI) must not exceed:

- $95,000 for single filers, with partial contributions allowed up to $110,000
- $150,000 for a married couple filing a joint return, with partial contributions allowed up to $160,000.

If you have earned income and are under age 70½, you may contribute to a Traditional IRA. In general, if neither you nor your spouse participated in a 401(k) or other qualified retirement plan, your contribution will be fully deductible. Even if you're an active participant in a qualified plan, you can receive the full deduction for the 2003 tax year if your AGI is:

- $40,000 or below for single filers, with partial deductions allowed up to $50,000
- $60,000 or below for married joint filers, with partial deductions allowed up to $70,000.

Note: For tax year 2004, each of these four deductibility figures is raised by $5,000.

For both types of IRAs, you must have earned income at least equal to the amount contributed. Married couples: If you file jointly, either spouse can have the requisite earned income.

2. Roth vs. Traditional

Both types are designed as long-term, tax-advantaged retirement accounts, but the way they are taxed differs markedly. Contributions to a Roth IRA are made with after-tax money and are never tax deductible. The Roth's tax benefits show up later, when you withdraw the money, completely federal income tax free after age 59½, if the account has been open for five years. Also, Roths have no mandated withdrawals in your lifetime, not even at age 70½. And you can continue to contribute to a Roth as long as you have earned income and meet income limits.

Only Traditional IRAs offer tax deductibility to investors who qualify, as well as tax deferral on earnings growth. You don't have to pay federal income taxes on the money until you withdraw it after age 59½. You also must begin withdrawing the money when you turn 70½ — a stipulation known as a Required Minimum Distribution (RMD). You can no longer contribute to a Traditional IRA after age 70½.

"Basically, Traditional IRAs enable you to take advantage of pretax contributions, and you pay taxes at whatever your current rate is in retirement," says Luciano. "The Roth gives you ability for tax-free growth versus tax-deferred growth." Luciano points out that you may want to consult a financial adviser about which type is best for your situation.

Illustration by Tatsuro Kiuchi

3. Spousal IRA

The Spousal IRA is specifically designed for families that have a spouse who is a) not employed; b) without enough income to fully fund an IRA; c) without a qualified retirement plan at work.

Spouses can choose either a Roth or Traditional IRA. In either case, contributions cannot total more than $3,000 for tax year 2003. If you file jointly, total contributions for working and non-working spouses cannot exceed $6,000 in tax year 2003. (With the catch-up contribution of $500 in tax year 2003, the couple could add a total of $1,000 to their contributions; see below.)

Be aware that the working spouse must have enough earned income to fund both IRAs. The entire amount contributed is tax deductible if the working spouse is not covered by an employer-sponsored plan. If the working spouse is covered, those contributions may be partially deducted, subject to income limits.

4. Contribution limits and deadlines

For both types of IRAs, your tax-year contributions must be made by the tax filing deadline of the following year — so you still have until April 15, 2004, to set up your IRA for the 2003 tax year. You may contribute up to $3,000 to your IRA for tax years 2003 and 2004, with the amount scheduled to gradually escalate to $5,000 in 2008. A special catch-up provision allows those age 50 and older to contribute an additional $500 each year through 2005. That catch-up provision increases to $1,000 beginning in 2006. The contribution limits are subject to certain phase-out rules: Consult your financial adviser for the limits in your particular situation.

5. "R" is for retirement

Uncle Sam created IRAs as a way to encourage long-term investing for retirement. Taking the money out prematurely — prior to age 59½ — can result in a 10% penalty. You can always withdraw your contributions to a Roth IRA, without a penalty. With both Traditional and Roth IRAs, you are allowed to withdraw contributions and earnings before retirement without penalty for certain reasons. Examples include a first-time home purchase, qualified education expenses, certain expenses related to long-term unemployment, and qualified medical expenses.

In addition to a penalty for early withdrawal, you may also owe federal income tax on the amount you withdraw from a Traditional IRA. "IRAs are truly designed for the long-term investor," cautions Luciano. "You really want to keep that money growing tax deferred or, in the case of a Roth, tax free, for as long as possible."

6. Getting started

Setting up an IRA is fairly straightforward. You can use a mutual fund company, brokerage firm, or bank. Many financial services firms allow you to make systematic contributions from a checking account. The range of investment choices to fund your IRA is extensive — including mutual funds, CDs, money markets, and individual securities. This is a real advantage when it comes to creating a diversified portfolio, notes Luciano. "You might start with one diversified mutual fund, and over time split your money among several funds with different styles to enhance diversity."

7. How to choose IRA investments

Most financial experts agree you should keep in mind your entire investment portfolio when considering how to allocate money in your IRA. Take note of what percentage of your 401(k) is in stocks, bonds, and cash, and look to "round out" your portfolio with your IRA.

"An IRA is a piece of the larger puzzle," sums up Luciano, "not something you look at independently. You want to make sure you have an appropriate asset allocation across your entire portfolio, factoring in your risk tolerance and the amount of time before retirement."

Make sure you understand the tax consequences of any withdrawal or distribution from an IRA or other retirement plan before you initiate one.

Talking savings with Peter Lynch

You're a freshly minted college graduate. You've landed your first job. You're contributing to a 401(k) plan and maybe even investing in the stock market through an IRA or a taxable account. With at least four decades between you and retirement, it might be difficult to envision those golden years.

If history is any indication, getting started early and putting your money in the stock market should pay off over the long term.

With that in mind, we're pleased to present the expert perspective of Peter Lynch, vice chairman of Fidelity Management & Research Co. and author of *Learn to Earn: A Beginner's Guide to the Basics of Investing and Business.*

What's the first thing young people should do before investing in the stock market?

Pay off credit cards and car and school loans, for sure. If you're paying 18% or 20% interest on a credit card or loan and the potential long-term return for stocks is 8% to 10%, it's better to pay off the loan.

Should young investors start contributing to a 401(k) or other workplace savings plans as soon as they can?

These plans are tax deferred. They're a nice way to invest. But you need to make certain decisions. You have to decide what percentage you want in equities, what percentage you want in bonds, and what percentage you want overseas, for example. So you need to do a little homework about asset allocation. By taking a set amount of money out of your paycheck and putting it into a workplace savings plan, you're also dollar cost averaging, which means you're buying more shares when the price is low and fewer when the price is high. The result is that your overall per-share costs are lower. It's automatic and not emotional. Emotional decisions in the market are often off the mark.

What are some of the advantages of investing in mutual funds?

Mutual funds were invented for people who want to own stocks but can't be bothered with the details. In a mutual fund, your only job is to send money, which gives you a certain number of shares in the fund. Your money is lumped together with a lot of other people's money. The whole pile is handed over to the expert who manages the fund. And you automatically become an owner of the dozens, even hundreds, of companies the fund had already bought.

Peter Lynch
Vice Chairman
Fidelity Management
& Research Co.

What about investing in individual stocks?

If you have the time and inclination, you can embark on a thrilling lifetime adventure: picking your own stocks. There is a lot more work than investing in a mutual fund, but you can derive a great deal of satisfaction from it.

Any other suggestions for young investors saving for retirement?

No matter your age, the key to reaching your long-term goals, such as retirement, is to identify your financial destination, chart a course to reach it, and then stay the course. Riding out the inevitable ups and downs of the stock market is often the hardest thing to do, but it is the best way to reach your long-term goals.

Dollar cost averaging does not ensure a profit or protect against loss in a declining market.

Mr. Lynch's views do not necessarily reflect the views or opinions of Fidelity Investments or the Fidelity funds.

This material is provided for informational purposes only and should not be used or construed as a recommendation of any security.

A mutual fund's share price, yield, and return will vary and you may have a gain or loss when you sell your shares.

HAVE YOU GOT A QUESTION FOR OUR PANEL OF EXPERTS?

Send it along via e-mail to **stages@fmr.com** or write to us at **STAGES, Ask + Answer, P.O. Box 55017, Boston, MA 02205**. Please note that we cannot answer questions about your specific financial circumstances.

Photograph by Fay Foto

Take control of your retirement planning

Fidelity NetBenefits® enhanced by two new online planning tools

Planning for retirement doesn't have to be a once-a-year event. And the convenience of the Internet makes it easier than ever to stay on top of your 401(k) strategy throughout the year, or as necessary. Fidelity NetBenefits® now includes two new online planning tools — Portfolio Analysis and Investment Research — that can help you better understand your investments, while also helping you make more knowledgeable investment decisions.

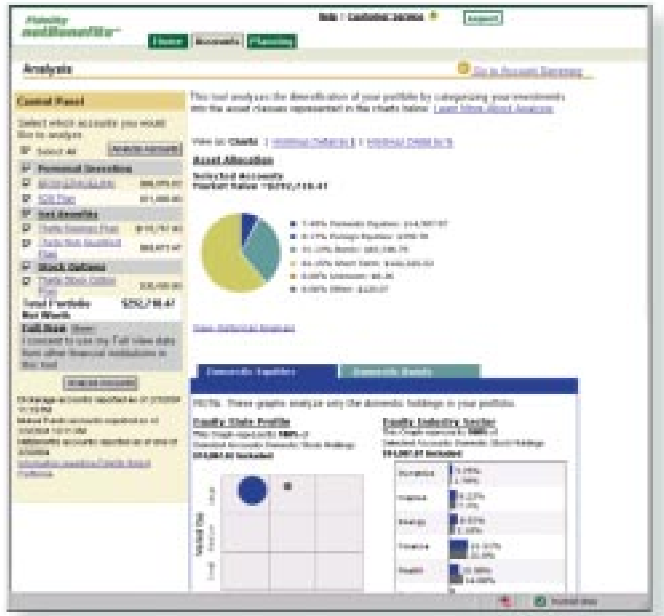
Portfolio Analysis

Looking to measure the overall diversification of your portfolio? This comprehensive diagnostic tool applies "look-through" methodology to examine the underlying holdings of each of your investments. Portfolio Analysis categorizes your investments to give you better understanding of your portfolio's diversification. The goal is to give you a more transparent view of the securities within your accounts. Check it out today to review the investment style and industry sector breakdown of your domestic equity and bond investments, or to compare your portfolio with an appropriate market index benchmark.

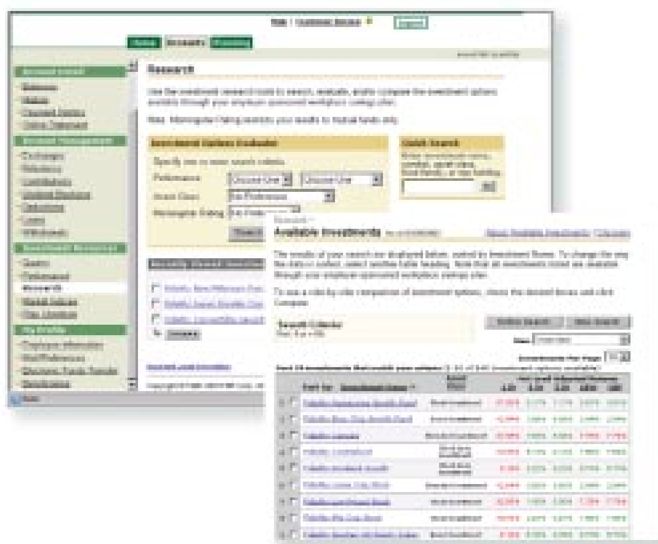
Investment Research

Considering an adjustment to your 401(k) investment lineup? The Investment Research tool enables you to completely screen and research the investment options available in your plan, helping to make you a more confident investor. Start by completing a quick search of plan investment options by fund name, fund family, symbol, or top holding. Then you're ready to evaluate and sort them by specific criteria such as performance, asset class, and Morningstar rating. The tool allows you to view detailed, side-by-side comparisons of up to five plan investment options.

Portfolio Analysis



Investment Research



Fidelity NetBenefits® is a comprehensive resource for retirement planning. Log in today at http://netbenefits.fidelity.com to review your retirement account using Portfolio Analysis, Investment Research, and other helpful planning tools.

360°

views and insight from every perspective

Half full

How I found retirement optimism, took charge of my future, and settled into the fast lane on the road to retirement.

By Margaret Malaspina

Illustration by Juliette Borda

On the road to retirement — to borrow a phrase from a popular advertising campaign — there are drivers and there are passengers. I've been both. In the driver's seat, I've spent most of my career in the investment business, helping large mutual fund companies educate shareholders about investing for retirement.

As the author of two books on retirement, I speak to investors who, like you, are saving for the big day. They talk about their retirement dreams — and their worst fears: "My savings will never amount to anything, so why bother?" "If I can't even pay my credit card bills, where will I find money to save for retirement?" "I'm maxing out my 401(k) plan, but it's still not growing fast enough."

As a passenger, I'm all too familiar with this sentiment. I got a late start on my own retirement savings. I was age 40 when I opened my first IRA, which promptly lost $400. While my young, single colleagues were maxing out their 401(k) contributions, I was a single mom with a mortgage payment and the looming prospect of college for my two kids.

Optimism prevails

Then something happened. An optimist about every other aspect of my life, I decided that my negative attitude toward saving for retirement had to go. I took a long, hard look at my financial resources, compared them with my goals, and concluded that saving a million bucks was unlikely. But I didn't panic. Instead, I realized that if I managed to save even $50,000 or $100,000, it could make a difference. I became a retirement optimist — someone who saw that there were lots of points between zero and a million — and decided to aim for one of them.

The optimist in me figured I might be able to do better if I learned more about investing. I searched for gems of wisdom, studied systems and formulas, and concluded that what I really needed to do was begin to follow the simple — and boring — lessons I had already learned. Invest for the long term. Diversify. Rebalance. I chose a core equity fund for my 401(k) plan and stayed with it. In the mid-1990s, I invested in bond funds while the stock market was going nuts. In 1999, I decided to look at asset classes that weren't in my portfolio, so I bought a real estate fund. In 2001, I bought a high-yield bond fund.

Retire in style

I also invested in myself. I figured if I *made* more money, I could *save* more money. And I did. Supplementing my regular income with freelance assignments, I had the opportunity to invest in both my employer's 401(k) plan and my own SEP IRA. Then, I left my job and started my own business — and got a little lucky. It's easier to get lucky when you are optimistic. And you'll never get lucky, financially or otherwise, if you're not in the game.

At age 59, I'm still a long way from retirement. But I'm a lot closer to that million dollars than I ever thought I would be. I've gone from feeling that retirement was an option only for the wealthy to believing that I, too, could retire — and even do it in style. Along the way, I've bought my own home, educated my children, and started my own business, all while saving the maximum every year for retirement. I picture myself taking my first really long vacation — a leisurely drive across the United States. California sunsets, Florida beaches, Big Sky country. Optimist in charge and enjoying the view from the driver's seat.

Margaret Malaspina writes about investing, and dreams of travel, from her office in suburban Boston.

home page

online retirement-planning resources from Fidelity

Results are in

Quarterly Market Perspective gets high marks

Since its launch on Fidelity NetBenefits® in August 2003, more than 70,000 investors have tuned in to the Quarterly Market Perspective (QMP). Why such interest? "Workplace savings plan investors are becoming more interested in stock market performance in relation to their retirement savings strategy," says Steve Deschenes, executive vice president of marketing at Fidelity Institutional Retirement Services Company. "The Quarterly Market Perspective is proving to be a useful multimedia tool for them."

Besides an avid interest in recent market performance, QMP viewers have responded enthusiastically to the online survey.

- **Nearly 80%** rated the QMP as very good or excellent
- **More than 90%** agreed that the content was informative, useful, and easy to understand
- **More than 80%** consistently say they are likely to watch future QMPs

QUARTERLY MARKET PERSPECTIVE

The hosts: **Rick Spillane and Bill Ebsworth** What is it: **An informative listen-and-learn recap of recent market performance, designed specifically for workplace savings plan investors like you** Where is it: **Login to your NetBenefits account and link on the "Planning" tab** When is it: **The QMP is updated in early January, April, July, and October.**

MEET THE HOSTS

Host: Bill Ebsworth
Born: Overseas (military brat)
Current title: Executive Vice President, Fidelity Institutional Retirement Services Co.
When I'm not at work: Outdoor activities with my family.
Historical person I most admire: Franklin Delano Roosevelt
Talent that I'd like to have: Music
Favorite writers: Robert Caro, Barbara Tuchman
My motto: Good judgment comes from experience. Experience comes from exercising poor judgment.
Biggest mistake I see that investors tend to make: Perfectionism. Successful investors learn from their mistakes; they don't dwell on them.
Investing is a lot like: Mountain biking. Having fun means taking some risks, knowing that you'll fall from time to time.

Host: Rick Spillane
Born: Boston
Current title: Executive Vice President and Head of Global Investment Strategy, Fidelity Management & Research Co.
When I'm not at work: Where's the first tee?
Historical person I most identify with: John F. Kennedy
Words or phrases I tend to overuse: Wicked
Favorite writer: Michael Lewis
My motto: Look ahead, not behind.
Biggest mistake I see that investors tend to make: Looking behind.
Investing is a lot like: A long, uphill par 5 into the wind.

Watch for the next **QMP** on **NetBenefits** in early **April** for a review of **first quarter 2004 market performance.**

STAGES | **FEATURE**

LOCATION, LOCATION

The concept of "asset location" is more important than ever following last year's tax cut. We explain the potential benefits of making careful decisions about which types of investments to hold in taxable accounts and which types can take full advantage of the opportunities provided by tax-deferred accounts such as your 401(k).

READ THIS FULL STORY INSIDE ON PAGE 12

real life | **REAL PEOPLE**

SUPER SAVER

A 36-year-old pilot seeks to simplify her overall financial plan. Can she do it?

Turn to page 7

real life | **PERSONAL FINANCE**

How do you measure up?

FINANCIAL RATIOS

Find out on page 5

expertise | **7 THINGS**

BEYOND YOUR 401(k)

GET ACQUAINTED WITH THE FUNDAMENTALS OF **IRA INVESTING**

Go to page 20

FOR INVESTORS IN PEAK SAVING YEARS

Fidelity INVESTMENTS®

STAGES® MAGAZINE
PO BOX 55017
BOSTON MA 02205-5017

PRSRT STD
US POSTAGE
PAID
FIDELITY
INVESTMENTS

Photograph by Tim Tadder. Illustrations by Karen Greenberg (top); John Ritter (center).

366561

Stg SPR04/Sav
1.797457